

FISCAL NOTE FOR NON-CAPITAL PROJECTS

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Legislation Title: A RESOLUTION amending Resolution 31334; clarifying the City's approach toward amortizing the unfunded liability of the Seattle City Employees' Retirement System (SCERS); and requesting that the SCERS Board of Administration and its actuary deliver to the City Council in 2014 an analysis of other potential assumption and policy changes designed to further strengthen the retirement system.

Summary of the Legislation:

The proposed Resolution updates Resolution 31334, which was passed by the City Council in 2011 and declared the City's intent to fully fund SCERS by a specific set of actuarial policies and assumptions. The original Resolution was intended to be analogous to RCW 41.45.035, which mandates specific actuarial assumptions and methods for State pension systems.

The proposed update would further clarify the amortization schedule for SCERS' unfunded liabilities, specifying a closed, fixed period of 30 years (2013-2042) to complete the process. The resolution also updates contribution rates for 2014 to be consistent with the January 1, 2013 Actuarial Valuation. The total rate is set to rise to 24.34% of payroll, of which 10.03% will continue to come from employee contributions and 14.31% will come from the City. Finally, the resolution asks the SCERS Board of Administration and its actuary to re-visit its assumptions and amortization methods and deliver recommendations to the City Council and Mayor by May 15, 2014, in preparation for the 2015-2016 Budget.

Background:

SCERS' unfunded liability is currently estimated at an actuarial present value of \$1.1 billion, largely due to investment losses in 2008, which affected pension plans nationally. Since then, the City has steadily increased its pension contributions to compensate, from a level of 16.06% of covered payroll to 24.34% of payroll by 2014. With Resolution 31334, the City committed to paying off the unfunded liability (amortizing it, in the parlance) over 30 or fewer years. However, in practice, the SCERS Board and its actuary, Milliman, have created a new, rolling 30-year period with each annual actuarial valuation, which is akin to refinancing a home mortgage annually. Milliman does not recommend continuing this rolling practice. If continued, a rolling amortization would spread the payoff over the indefinite future, with several undesirable effects, including:

- Allowing negative amortization, in which the unfunded liabilities grow during the initial years of the payoff, to continue indefinitely;
- Increasing total City costs, as more of the benefit dollars would need to come from

- contributions rather than investment returns;
- Further harming intergenerational equity, as taxpayers in the far future would be asked to finance benefits for service long past; and
- Increasing the risk of underfunding the system in the future, as SCERS' funded ratio would be expected to rise more slowly.

The Resolution ends the rolling amortization practice starting with the current January 1, 2013 valuation and sets a closed, fixed period of 2013-2042 for the amortization in future valuations. It also incorporates two elements of flexibility in this approach. In the first, the SCERS Board and its actuary are invited to propose separate amortization layers and periods for any new unfunded liabilities or surpluses that arise after January 1, 2013. In the second, the Council signals that it may consider re-opening the period in the second half of the amortization, if year-to-year valuation changes would result in excessive contribution rate volatility. This re-opening is not a given, however. Alternative approaches would include raising the contribution rate in response to volatility and then leaving it raised until the unfunded liability is paid off.

This legislation does not have any financial implications.

(Please skip to "Other Implications" section at the end of the document and answer questions a-h. Earlier sections that are left blank should be deleted. Please delete the instructions provided in parentheses at the end of each question.)

X This legislation has financial implications.

(If the legislation has direct fiscal impacts (e.g., appropriations, revenue, positions), fill out the relevant sections below. If the financial implications are indirect or longer-term, describe them in narrative in the "Other Implications" Section. Please delete the instructions provided in parentheses at the end of each title and question.)

This resolution has only indirect financial implications.

Other Implications:

a) Does the legislation have indirect financial implications, or long-term implications?

This resolution has only indirect financial implications. It will not affect the 2014 contribution rate. All other things being equal, contribution rates would be expected to follow the path specified in the January 1, 2013 Actuarial Valuation for the next 30 years.

Year	Contribution Rate as a % of Covered (Non-Overtime) Payroll
2014	24.34%
2015	23.91%
2016	23.69%
2017	23.60%
2018	23.26%
2019 and after	23.08%

SOURCE: Milliman January 1, 2013 Actuarial Valuation, p. 32

Note: Rate changes in the first 5 years of the amortization are due to asset smoothing.

However, required contributions under a closed, fixed amortization will generally be a bit higher in 2015 and later than they would be in a rolling / open structure. How much higher would depend on future investment performance and other experience.

b) What is the financial cost of not implementing the legislation?

The City's total pension costs should be lower with the closed, fixed amortization than with a rolling amortization, in that dollars contributed earlier have more time to earn an investment return before being used for benefits. The investment return assumption of 7.75% is higher than any discount rate that the City typically uses for budget decisions, with the implication that dollars contributed earlier to SCERS would be expected to have a positive net present value. No specific estimates of this value have been attempted.

c) Does this legislation affect any departments besides the originating department?

Yes, this resolution affects the pension contribution rates paid by all City departments, including the utilities.

d) What are the possible alternatives to the legislation that could achieve the same or similar objectives?

A variety of other changes to SCERS' actuarial assumptions and amortization policies could achieve the same or additional benefits, with similar or higher future budget impacts. The SCERS Board intends to revisit all its assumptions with an Experience Study in 2014. In addition, the City and SCERS expect that various actuarial societies, bond rating agencies, and government finance standards bodies will be revisiting their guidance for pension funding in the coming years.

e) Is a public hearing required for this legislation?

No

f) Is publication of notice with *The Daily Journal of Commerce* and/or *The Seattle Times* required for this legislation?

No

g) Does this legislation affect a piece of property?

No

h) Other Issues:

List attachments to the fiscal note below:

None